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In the Supreme Court of the United States

OCTOBER TERM, 1979

ROGER DOLESE, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNTIED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.
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Washington, D.C. 20530

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Petitioners seek review of the decision below which held that (1) several corporations could not claim income tax deductions for legal expenses they paid in connection with their controlling shareholder's divorce action; (2) the corporations' payments of those legal expenses were constructive dividends that were taxable to the controlling shareholder; and (3) advances made by the corporations for payment of their controlling shareholder's personal living expenses were dividends and not loans.

The pertinent facts may be summarized as follows: In 1959, petitioner Roger Dolese's wife, Ardith, instituted a divorce proceeding against him (Pet. App. 26a; V-R. 2-3,

8-12, 13-19, 102, 104-105).[1] These proceedings were both protracted and expensive. Over the nine-year term of the litigation, the parties incurred legal, investigative and other expenses totalling approximately $1.3 million (Pet. App. 26a; III-R. 39). Certain aspects of the divorce action focused upon Roger's activities vis-a-vis the corporate petitioners and, pursuant to Oklahoma law, the corporate petitioners were named parties to the divorce action[2] (Pet. App. 26a-27a; V-R. 15-16).

Under a court order entered early in the divorce litigation, the corporations were prohibited from paying certain investigative expenses associated with the proceedings. Thereafter, however, the state court issued a series of orders requiring that the three corporate petitioners and Roger each pay one-fourth of the legal fees and expenses incurred by the parties to his divorce action (Pet. App. 27a; III-R. 42-43; V-R. 5-6). The divorce court further ordered that the corporations each pay one-fourth of the litigation expenses Roger had previously paid (Pet. App. 27a-28a).

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[1]"I-R." through "XIII-R." refers to the thirteen volumes of the separately bound record appendix filed in the court of appeals.

[2]Petitioner Roger Dolese owned 100% of the stock of The Dolese Company, and Roger and The Dolese Company, together, owned 100% of the Dolese Bros. Co. Until January 17, 1969, The Dolese Company also owned 80% of the Dolese Concrete Company. Pursuant to the divorce settlement order, the 20% interest in the Dolese Concrete Company previously owned by Ardith and a trust for the Dolese children was redeemed, thereby giving The Dolese Company 100% control of the Dolese Concrete Company (Pet. App. 27a).

Each of the corporate petitioners claimed income tax deductions for all the litigation expenses they paid directly and indirectly through Roger (Pet. 6; Pet. App. 28a). On audit, the Commissioner of Internal Revenue determined that these payments were not deductible, but were constructive dividends to Roger (Pet. 6; Pet. App. 28a).

From 1948 onward (and during the nine years the divorce action was pending), The Dolese Company and the Dolese Concrete Company paid most of Roger's personal living expenses. On the books of the corporations, these payments were recorded as loans, although Roger paid no interest on the "advances" until after 1964 (Pet. App. 28a). Through 1964, Roger Dolese had withdrawn a net amount of $1,545,156.18 from the corporations in this fashion (III-R. 66-68, 157). The Dolese Company declared no formal dividends between 1957 and 1968 (II-R. 108).

During the period in question—1966-1968—Roger received net advances from the corporations totalling $489,263: $187,436 in 1966, $151,761 in 1967, and $150,066 in 1968. As of March 31, 1968, the corporations' records reflected a balance of $1,817,133 in "advances" outstanding. Beginning in 1964, Roger began to give the corporations four percent, one-year notes to account for his "advances." None of these notes was ever paid when they became due (Pet. App. 28a). Rather, the following year, Roger would pay the accrued interest and then execute a new, short-form note covering amounts previously owed plus new advances (Pet. App. 28a). Roger gave no collateral to secure these notes (III-R. 69).

The corporations made no attempt to enforce payment and Roger's payments, during the years in question, were virtually de minimis[3] (Pet. App. 29a; III-R. 159-167; V-R. 299). On audit for 1966-1968, the Commissioner determined that the corporations' "advances" made to Roger were taxable to him as dividends (Pet. 7; Pet. App. 29a).

Petitioners paid the deficiencies resulting from the Commissioner's determinations and thereafter brought these refund suits in the United States District Court for the Western District of Oklahoma. The district court granted summary judgment in favor of the government[4] (Pet. App. 16a-17a) and the court of appeals affirmed that decision in part (Pet. App. 25a-38a). It held that under the "origin of claim test" of *United States* v. *Gilmore*, 372 U.S. 39 (1963), the bulk of the expenses originated in the personal divorce action and was therefore not deductible by the corporate petitioners. In the court's view, only those expenses relating to obtaining judicial approval of transactions the corporations wished to enter were sufficiently business connected to qualify for deduction. The court further held that the expenditures that were not

[3]In 1969, after the years here in issue, the corporations credited $450,566.19 to Roger's account. These credits were not the result of any payment by Roger. Rather, the corporate petitioners credited to Roger's account the amounts they were ordered to reimburse him for divorce litigation costs he had previously paid. In 1970, $599,900 was credited to his account, but a like amount was "readvanced" to him on the same day the credit was recorded (Pet. App. 29a; III-R. 168, 172).

[4]On April 29, 1975, the district court granted the government's motion for summary judgment (Pet. App. 5a-6a). The court of appeals reversed that first judgment on procedural grounds and remanded the case to the district court (Pet. App. 20a-24a). On remand, the district court again entered summary judgment in favor of the government (Pet. App. 16a-17a).

deductible by the corporations were constructive dividends to Roger because those payments were personal in origin and conferred an economic benefit on Roger (Pet. App. 29a-34a). Finally, the court ruled that the corporations' advances to Roger were taxable as dividends. As it observed in denying the petition for rehearing, "no permissible inference of either an intent to repay or an expectation of repayment can be drawn" (Pet. App. 42a).

1. The court of appeals was correct in partially affirming the district court's summary judgment in favor of the government. It is settled that summary judgment is appropriate when there is no genuine dispute as to any material issue of fact. Rule 56, Fed. R. Civ. P.; *Ando* v. *Great Western Sugar Co.*, 475 F. 2d 531, 535 (10th Cir. 1973). The record here, consisting of affidavits, documentary exhibits and depositions (Pet. App. 32a), fully established the factual and legal bases for the decision below. As this Court held in *United States* v. *Gilmore*, *supra*, 372 U.S. at 48, "the characterization, as 'business' or personal,' of the litigation costs of resisting a claim depends on whether or not the claim *arises in connection with* the taxpayer's profit-seeking activities" (emphasis in original). And there is no ground to dispute that the legal expenses for which no deduction was permitted in the present case had their genesis in a personal divorce dispute. No matter whether those expenses were paid by the corporations controlled by Roger or by Roger himself, they remain nondeductible, personal expenses as long as they arose from that personal source. *Hartwell* v. *Commissioner*, Tax Ct. Mem. Dec. (P-H), para. 65,049 (1965). The court of appeals therefore correctly held that only those legal costs that had their origin in the profit-making activities of the corporate petitioners are deductible (Pet. App. 32a-33a).

The decision below likewise correctly concluded that the portion of the corporations' legal expenses attributable to Roger's personal divorce litigation and the amounts they advanced to Roger were taxable to him as dividends. The conclusion that the legal payments were dividends flowed automatically from the conclusion that they were personal in tax character. *Weil* v. *Commissioner*, Tax Ct. Mem. Dec. (P-H), para. 67,078 (1967); *Hartwell* v. *Commissioner*, *supra*; cf. *Greenspon* v. *Commissioner*, 229 F. 2d 947 (8th Cir. 1956). The conclusion that the "advances" were taxable to him followed from the holding that Roger had no intention to repay the alleged loans. *Oyster Shell Products Corp.* v. *Commissioner*, 313 F. 2d 449 (2d Cir. 1963); *Roschuni* v. *Commissioner*, 271 F. 2d 267 (5th Cir. 1959), aff'g 29 T.C. 1193 (1958).

2. Petitioners urge (Pet. 14-31) that the courts below erred in concluding that summary judgment was an appropriate means of deciding these issues, particularly since such a resolution hinged to an extent upon subjective factors. See *Poller* v. *Columbia Broadcasting System*, 368 U.S. 464 (1962). The resolution of the tax treatment of the litigation expenses did not turn primarily upon subjective factors, but rather upon the source of the claims under litigation. *United States* v. *Gilmore*, *supra*. While the tax treatment of the corporate advances does turn largely upon such subjective factors, a person is not "entitled to a trial simply because he has asserted a cause of action to which state of mind is a material element. There must be some indication that he can produce the requisite quantum of evidence to enable him to reach the jury with his claim." *Hahn* v. *Sargent*, 523 F. 2d 461, 468 (1st Cir. 1975), cert denied, 425 U.S. 904 (1976)); *Washington Post Company* v. *Keogh*, 365 F. 2d 965 (D.C. Cir. 1966). As the court of appeals properly noted (Pet. App. 42a), petitioners' proof fell well short of that mark. Accordingly, summary proceedings were entirely appropriate.

3. Finally, contrary to petitioner's assertions (Pet. 31-35), the decision below does not conflict with *United States* v. *Smith*, 418 F. 2d 589 (5th Cir. 1969), or *Ruben* v. *Commissioner*, 97 F. 2d 926 (8th Cir. 1938). In both of those cases, corporations paid certain amounts to satisfy claims lodged with respect to their own and their shareholders' "profit-seeking activities." The courts held that payments in satisfaction of those claims might not be attributed to the shareholders because they had been prompted by corporate business purposes. Thus, those decisions, holding that the payments were not constructive dividends to the shareholders do not turn upon the enforceable nature of the corporations' obligations, but upon the fact that the expenditures served corporate business purposes.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.
Solicitor General

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